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STATE OF CALIFORNIA

## STATE BOARD OF EQUALIZATION

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Executive Director

February 28, 1995

Mr. \_\_\_\_\_

**Re: Opinion - Change of Ownership**

Dear Mr. \_\_\_\_\_

This is in response to your letter of November 8, 1994 to the Legal Division of the State Board of Equalization in which you request that we confirm that the proposed transactions described in your letter and set forth below do not constitute a "change of ownership" under Revenue and Taxation Code<sup>1</sup> section 60.

### Facts

1. Description of Parties and Properties.

The subject property consists of raw land ("Land"). It is owned by the Family Trust.

2. Husband and Wife are Husband and Wife Under California Law.

They have resided in California during all relevant times. The Land during all relevant times was Husband and Wife's community property, but title is presently held in the Family Trust.

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<sup>1</sup>All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

Husband and Wife have two children - Tom and Tina. Those children are recognized as Husband and Wife's children under California law. Said children were not adopted.

Husband and Wife have six grandchildren ("Grandchildren") through Tom and Tina.

3. Family Trust.

The Family Trust is a revocable, inter-vivos, grantor trust in which Husband and Wife are the grantors, trustors, trustees, and current beneficiaries. Children, grandchildren, and certain other persons will become the beneficiaries in the event of the death of Husband and/or Wife.

4. Newco and Realco are California "S" Corporations.

Newco and Realco have made "S" elections to be treated as S-Corporations under applicable state and federal law. All of the outstanding stock of Newco will be owned by the Family Trust. All of the outstanding stock of Realco will be owned as follows:

1/3 Family Trust  
1/3 Tom's Trust  
1/3 Tina's Trust

5. FLP.

FLP is a California limited partnership in which Newco and Realco are the general partners holding 3% partnership interests (each) and the following, pursuant to the transactions described below, will be limited partners and have the following interests in profits/losses and capital:

a. The Family Trust	16%
b. Tom's Trust	24%
c. Tina's Trust	24%
d. Grandchildren's Trust	30%

6. Tom's Irrevocable Trust established by Husband and Wife.

The beneficiary of said Trust is Tom. Tom has a general power of appointment with respect to the corpus of the trust and the trustee may invade the income and principal of the trust for his health, education, welfare, and support.

7. Tina's Irrevocable Trust established by Husband and Wife.

The beneficiary of said Trust is Tina. Tina has a general power of appointment with respect to the corpus of the trust and the trustee may invade the income and principal of the trust for her health, education, welfare, and support.

8. The Grandchildren's Trust.

The Grandchildren's Trust is an irrevocable trust established by Husband and Wife for benefit of their grandchildren. The beneficiaries of the trust shall be the grandchildren. The Trustees shall distribute income and principal to the grandchildren for their "health, welfare, education, and support" as determined at the discretion of the Trustees.

Proposed Transactions

a. The Family Trust will transfer 100% fee interest in the Land to Husband and Wife, as their community property.

b. Husband and Wife will transfer title to the Land as follows:

- i. 30% tenancy-in-common interest to Husband as his separate property;
- ii. 70% tenancy-in-common interest in Husband and Wife, as community property;

c. Husband will transfer his 30% tenancy-in-common interest (separate property) in the Land as follows:

- i. 15% to Tom's Trust;
- ii. 15% to Tina's Trust.

Each 15% interest has a value of less than \$500,000. Husband will utilize his \$1,000,000 exemption with respect to said transfers pursuant to Rev. & Tax. Code, Sec. 63.1 (a)(2) & (c)(7).

d. Husband and Wife will transfer their 70% community property interest in Land as follows:

- i. 3% to Newco as a capital contribution in exchange for 100% of the stock of Newco to be held as community property;

- ii. 1% to Realco as a capital contribution in exchange for 33-1/3% of the outstanding stock of Realco to be held as community property;
  - iii. 66% to FLP in exchange for a 66% limited partnership interest in FLP to be held as community property (capital contribution).
- e. Husband and Wife will then transfer a 30% limited partnership interest in FLP to the Grandchildren's Trust.
- f. Husband and Wife will then transfer limited partnership interests in FLP as follows:
- i. 10% to Tom's Trust; and
  - ii. 10% to Tina's Trust.
- g. Tom's Trust will then make the following transfers with respect to its 15% tenancy-in-common interest:
- i. 1% transfer to Realco as a capital contribution in exchange for 33-1/3% of the stock of Realco;
  - ii. 14% tenancy-in-common interest to FLP as a capital contribution in exchange for a 14% limited partnership interest in FLP.
- h. Tina's Trust will then make the following transfers with respect to its 15% tenancy-in-common interest:
- i. 1% transfer to Realco as a capital contribution in exchange for 33-1/3% of the stock of Realco;
  - ii. 14% tenancy-in-common interest to FLP as a capital contribution in exchange for a 14% limited partnership interest in FLP.
- i. Realco and Newco will contribute their respective 3% tenancy-in-common interests in the Land to the FLP as capital contributions in exchange for their respective 3% general partnership interests.
- j. Husband and Wife will transfer the 16% balance of their limited partnership interest and their 100% and 33-1/3% shares in Newco and Realco, respectively, to the Family Trust.

Our opinion with respect to each of the foregoing transactions in the order presented is as follows:

a. The transfer of the Land from the Family Trust to Husband and Wife would be excluded from change in ownership under section 62, subdivision (d).

b. The transfers of interests in the Land between Husband and Wife are excluded from change in ownership under section 63.

c. The transfer of a 30 percent interest in the Land by Husband to Tom's Trust and Tina's Trust equally is a change in ownership but could be excluded from change in ownership under section 63.1, subdivision (a)(2) and (c)(7) provided timely claims are filed.

d. The transfer of a 3 percent interest in the Land to Newco by Husband and Wife in exchange for all of the stock of Newco to be held as community property would be excluded from change in ownership under section 62, subdivision (a)(2) and Rule 462(j)(2)(B).

The transfer of a 1 percent interest in the Land to Realco by Husband and Wife in exchange for 1/3 of the outstanding stock of Realco to be held as community property would be excluded for the same reason, i.e., before the transfer, Husband and Wife would own a 1 percent interest in the Land and after the transfer Husband and Wife would own a 1 percent interest in the land through their 1/3 stock ownership of Realco which we assume would own a 3 percent interest in the Land as a result of the transfers by Tom's Trust and Tina's Trust of a 1 percent interest each in the Land to Realco in addition to the transfer by Husband and Wife.

The transfer of the 66 percent interest in the Land to FLP by Husband and Wife in exchange for a 66 percent interest in FLP to be held as community property would also be excluded for the same reason.

e. The transfer of the 30 percent partnership interest in FLP by Husband and Wife to the Grandchildren's Trust would be excluded from change in ownership under section 64, subdivision (a) and Rule 462(j)(3).

f. The transfers of the 20 percent partnership interests in FLP by Husband and Wife to Tom's Trust and Tina's Trust equally would be excluded from change in ownership for the same reason set forth in (e) above.

g. The transfer by Tom's Trust of a 1 percent interest in the Land to Realco in exchange for 1/3 of the stock by Realco would be excluded from change in ownership for the same reasons

set forth in (d) above as would the transfer by Tom's Trust of the 14 percent interest in the Land to FLP in exchange for the 14 percent limited partnership interest in FLP.

h. The transfers by Tina's Trust would be treated the same as the transfers by Tom's Trust.

i. The transfers by Realco and Newco of their respective 3 percent tenancy-in-common interests in the Land to FLP in exchange for their respective 3 percent general partnership interests would be excluded from change in ownership for the same reasons set forth in (d) above. That is, we assume that FLP would then own a 100 percent interest in the Land and Realco and Newco would continue to own the same percentage interest in the Land through their 3 percent ownership interests in FLP.

j. The transfer by Husband and Wife of their 16 percent limited partnership interest in FLP and all their shares in Newco and Realco to the Family Trust would be excluded from change in ownership under Rule 462(i)(2)(B).

The net effect of the foregoing proposed transactions is that FLP would own a 100 percent interest in the Land and the partnership interests in FLP would be owned 30 percent by the Grandchildren's Trust, 24 percent by Tom's Trust, 24 percent by Tina's Trust, 3 percent by Realco, 3 percent by Newco and 16 percent by the Family Trust.

Were this result to be accomplished directly, i.e., by Family Trust conveying the Land to FLP and interests in FLP distributed by FLP in the percentages shown above, there would be a change in ownership of the Land under section 61, subdivision (i) and Rule 462(j)(1). See example (ii) under Rule 462(j)(2)(B).

Even were this result accomplished in a slightly less direct manner, i.e., by the Family Trust conveying the Land to FLP in exchange for all of the partnership interests in FLP and the subsequent distribution of the partnership interests by the Family Trust in the percentages shown above, there would be a change in ownership of the land under section 64, subdivision (d) and Rule 462(j)(4)(B).

Since the end result reached directly, i.e., change in ownership of the Land, is different than the result reached in the proposed transaction involving additional steps, the issue arises as to the substance of the transaction and the applicability of the step transaction doctrine.

We recognize that, under section 2 of Ch. 48, Stats. 1987, and the specific examples described therein, the step transaction doctrine does not apply to certain transactions between parents and children which, but for such section, might otherwise, be subject to the step transaction doctrine. In this case, however, the proposed transactions are not restricted to parents and children as are the transfers in that section but include grandchildren as well. Without deciding whether a transaction is insulated from application of the step transaction doctrine under the language of section 2 only where a child or children are the sole owner or owners of the entity owning the real property, it is very clear that transactions under which grandchildren also hold ownership interests in such entity are not included in the section 2 language. Thus, such transactions would not be insulated from the step-transaction doctrine. (For your information, Resolution Chapter 110 of the Statutes of 1994; ACA 17, Knowles, will, if approved by the voters at the March 26, 1996, election, extend the parent-child exclusion to a limited class of transfers of property between grandparents and grandchildren. Until that time, a grandchild cannot qualify as an "eligible transferee" for purposes of the exclusion.) Accordingly, we don't believe the proposed transactions are insulated from the application of the step transaction doctrine under section 2 of Ch. 48 of Stats. of 1987, simply because one of the proposed transactions involves an interim transfer of a 30 percent undivided interest in the Land for the benefit of the children of Husband and Wife.

The position of the Board with respect to the applicability of the step transaction doctrine is based on Shuwa Investments Corporation v. Los Angeles County (1991) 1 Cal.App.4th 1635 and is set forth in LTA 92/69 dated October 14, 1992, a copy of which is enclosed for your easy reference. That letter summarizes the Board's current position as follows:

It is the position of the Board, therefore, that future step transaction decisions should be made by assessors based upon all of the facts of each transaction. If those facts demonstrate that in substance a change in ownership occurred, then the transaction should be treated accordingly. The existence of independent business purposes of the various steps will not prevent the application of the step transaction doctrine. Finally, the assessor may be aided in determining what the true substance of the transaction was by applying the (1) end result test, (2) interdependence test, and/or (3) binding commitment test, as set forth in the Shuwa decision.

Mr.

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February 28, 1995

See, also, the recent case of McMillan-BCED/Miramar Ranch North v. County of San Diego (1995) 95 Daily Journal D.A.R. 608 wherein the court held that satisfaction of only one of the three tests is sufficient to find the step transaction doctrine applicable.

Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

The views expressed in this letter are, of course, only advisory in nature. They are not binding upon the assessor of any county. You may wish to consult the appropriate assessor in order to confirm that the described property will be assessed in a manner consistent with the conclusions stated above.

Very truly yours,

Senior Staff Counsel

EFE:ba

Enc.

cc: Mr. -

Mr. ' .

Ms. ....

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